The Heritage Foundation
LEADERSHIP FOR AMERICA

ISSUE BRIEF

No. 3582 | APRIL 26, 2012

The New Model BIT: Necessary but Not Sufficient

Derek Scissors, PhD

Bilateral investment treaties (BITs) extend fundamental trade principles, such as nondiscrimination among partners, to investment. In 2009, the Obama Administration began revising the model BIT, the outline that the U.S. initially provides other countries. This month, the revised model BIT was released. The Administration touts it as improving labor and environmental standards, transparency, and treatment of state-owned enterprises (SOEs).[1]

Labor and environmental standards have drawn perhaps too much attention. It is important that the U.S. should continue to seek BITs with a number of countries, and the labor and environmental amendments should not interfere with those talks.

The new model BIT remains inadequate for a smaller set of countries. There are still notable problems in transparency, treatment of SOEs, and other areas. Some of these issues are unavoidable in a model document. But some countries have economies and regulatory systems that clash with American goals for a bilateral investment treaty. The new model does not sufficiently address this set of challenges.

The New Model BIT. The U.S. currently has BITs with 40 countries. The BIT process has two dimensions: (1) negotiation, and (2) implementation. The model BIT is America's negotiation starting point. With some countries, negotiating the final terms of a BIT can be difficult.

The core of a BIT is national treatment: Foreign and domestic entities and items should be treated equally. This is fairly easy to apply to foreign goods but more difficult to apply to foreign investors. Much of the model BIT consists of detailing how this is to be done.

For example, a key right for investors is the ability to transfer money across borders in the currency of their choice. This is documented at length in the new model BIT. Countries with restrictions on the cross-border flow of money—capital account restrictions—would require modifications to a BIT. These modifications would reduce its value to the U.S.

The labor and environmental provisions are another potential drawback. If the U.S. uses them as a means to coordinate implementation of various labor and environmental standards, this is well and good. If they are used as an excuse not to move forward with BITs, they will essentially deny to American investors protections that the U.S. already offers foreign investors. This would do nothing but hurt the American economy.

The model BIT nonetheless has a great deal of value. It affirms longstanding principles in treatment of investors and offers a fairly robust dispute settlement mechanism. It also improves protection against host country demands for technology transfer and localization of supply.[2] It is an adequate basis for many BITs that the U.S. should pursue.

Challenging Countries. In addition, the new model BIT has been portrayed as clearing a path for signing agreements even with economies that have troublesome features, such as a leading role for SOEs.[3] It is not adequate for this task. Further negotiation could remedy these flaws. As it stands, though, China, India, and others will likely not implement the

This paper, in its entirety, can be found at **http://report.heritage.org/ib3582**

Produced by the Asian Studies Center

The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002
(202) 546-4400 | heritage.org

provisions of the model BIT in a way that benefits American investors.

The concerns with India can be characterized as recognized but entrenched weaknesses in the Indian economy, weaknesses that the Indian government might want to solve but does not seem to be able to.

Investors need a transparent environment and prompt responses from the government and legal system when problems arise. The model BIT clearly recognizes this.[4] India under the current government is not known for transparency or promptness in regulatory response, and no document will alter this. Ownership rights are the core of investment, but India has long-standing problems with property rights, such as for land and related compensation for lost ownership.

The model BIT's gaps with regard to China concern problems that its government does not want to solve. Among other flaws, the model BIT recognizes only those SOEs that are formally delegated authority by the relevant government.[5] This is insufficient with regard to current Chinese SOEs, as it would be easy for Beijing to circumvent the changes to the new BIT. In short order, most Chinese SOEs would not be covered by this model BIT.

There are also exemptions from BIT requirements in cases where local competition laws are applied. In China, these have been heavily biased in favor of SOEs and against foreign firms. The model BIT is ineffective in this regard as well.

Almost as important, much of the model BIT relies implicitly on the rule of law in the form of an independent judiciary, the possibility of independent tribunals, and so on. The Communist Party is above the law, the judiciary is a political tool,[6] and the arbitration outlined in the model BIT would not be determined according to recognized principles.

The model BIT text on transparency makes exemptions for "essential security" and "public interest" big enough to drive a missile-bearing truck through. Beijing's enormously broad definitions of these terms, as well as "state secrets," would block implementation of the transparency provisions.[7]

What the US Should Do.

- The U.S. should proceed with BIT negotiations with those countries that can and will genuinely protect American investors. The new labor and environmental provisions should not be permitted to interfere with these talks.
- The new model BIT should not be used as a basis for negotiations with China and perhaps India and certain other countries. Protecting American investors in such countries would require considerable augmentation of model BIT provisions.
- The Trans-Pacific Partnership (TPP) offers an opportunity to improve treatment of SOEs. The U.S. should conclude a TPP that remedies as many weaknesses of the model BIT as possible, then use TPP to guide BIT talks. For example, the definition of SOE should be changed from the model BIT, and regulatory protection of SOEs should be addressed.

Some BITs Are Better Than Others. A good BIT helps the U.S. and the new model BIT enables a number of good BITs. There are potential partners, though, for whom the new model is not nearly enough. BIT negotiations with these countries should not proceed on the basis of the model. Much more needs to be done first.

*—**Derek Scissors, PhD,** is Senior Research Fellow in Asia Economic Policy in the Asian Studies Center at The Heritage Foundation.*

1. U.S. Department of State, "Model Bilateral Investment Treaty Fact Sheet," April 20, 2012, http://www.state.gov/r/pa/prs/ps/2012/04/188199.htm (accessed April 25, 2012).
2. News release, "U.S. Chamber Welcomes Conclusion to Review of Model Investment Treaty," U.S. Chamber of Commerce, April 20, 2012, http://www.uschamber.com/press/releases/2012/april/us-chamber-welcomes-conclusion-review-model-investment-treaty (accessed April 25, 2012).
3. Doug Palmer, "U.S. Resolves 3-Year Debate on Investment Treaty Terms," Reuters, April 20, 2012, http://www.reuters.com/article/2012/04/20/us-usa-investment-treaties-idUSBRE83J15L20120420 (accessed April 25, 2012).
4. U.S. Department of State, "2012 U.S. Model Bilateral Investment Treaty," http://www.state.gov/documents/organization/188371.pdf (accessed April 25, 2012).
5. U.S. Trade Representative, "Model Bilateral Investment Treaty," http://www.ustr.gov/about-us/press-office/fact-sheets/2012/april/model-bilateral-investment-treaty (accessed April 25, 2012).
6. See Sui-Lee Wee, "China Orders Lawyers to Pledge Allegiance to Communist Party," Reuters, March 21, 2012, http://www.reuters.com/article/2012/03/21/us-china-lawyers-idUSBRE82K0G320120321 (accessed April 25, 2012).
7. Sky Canaves, "Beijing Revises Law on State Secrets," *The Wall Street Journal*, April 29, 2010, http://online.wsj.com/article/SB10001424052748703572504575213944098022692.html (accessed April 25, 2012).